Foreign Currency
Q & A with Chris Brower

Chris Brower is the Vice President of Global Capital Markets/FX at Comerica Bank where he has worked for over 14 years within the Global Markets Arena. He spent 5 years working with audits for the Global Capital markets team, and has worked at the FX trading desk for the last 9 years.

Q: In order for my small/medium size business to be competitive in an international market, should I create a foreign currency account or are there alternatives?

A: Opening an account denominated in a foreign currency is certainly an option. Is it the best option? That depends on the makeup of your international payment flows. Currency accounts may be a viable solution if you have both payables and receivables denominated in the same currency. If you do, then a currency account might be a good solution because it allows you to keep foreign currencies that are received until the time comes to make payments in those same foreign currencies. Therefore, conversion costs are not a concern.

If, however, your company is only receiving payments, or only making payments, in foreign currencies, then a foreign currency account may not be a good solution for two reasons. First, a currency account offers no protection from currency rate swings while balances are maintained in this account, and at some point your funds will have to be converted into U.S. dollars. Second, the fee structure of foreign currency accounts may be costly.

Again, currency accounts may be a viable option if your company runs a natural hedge position between receivables and payables. For example, you have a currency account in Canadian dollars to support your Canadian operations. Because revenue from your sales in Canada is deposited into the account and payments are also made from that account – all in Canadian dollars – there is no currency conversion.

Q: Doing business internationally means that there is disparity between currencies. What kinds of options are available for my small/medium size business that can lessen the risks of currency exchange?

A: There are several options available to help mitigate the risks of currency exchange. One, mentioned above, is opening up an account that is denominated in the currency in which you are doing international business. This is a viable option if the circumstances are similar to those mentioned above.

Another option could be entering into forward contracts with a financial institution which is well versed in FX risk management and global cash management operations. Forward contracts allow you to lock in today's rates for your stream of future payables or receivables. A forward contract requires delivery on a future date of a specified amount of one currency for a specified amount of another currency at a fixed exchange rate. This alternative enables the contract purchaser to specify the delivery date and currency amounts necessary to efficiently ensure the financial integrity of the transaction. As an example, you enter into a forward contract, with your financial institution, to buy 50,000 euro @ 1.1350 which is payable November 30th 2016. Between today and November 30th you are unaffected by currency rate fluctuations because you have locked in a forward. Again, it is locking in a future payable/receivable at today's rate.

Depending on your financial institution you might also have the ability to enter into a foreign currency swap. A currency swap is the simultaneous purchase and sale of the same amount of a given currency for two different dates, against the sale and purchase of another currency. Swaps are a cash management tool that gives you the ability to control cash flows, reduce foreign exchange risk, and aid in the conversion of cash flows into one currency. Also, a swap also can be used to adjust the timing of cash flows with an existing foreign exchange transaction with your financial institution.

Q: As exchange rates fluctuate on a daily basis, what should my small/medium size business know in regard to currency fluctuations before entering into contracts with overseas business partners?

A: While being open to paying and receiving foreign currencies it is important to understand past and present currency rates and the current rate of forward contracts when preparing bids to foreign counterparties. Use your financial institutions' foreign exchange desk to work through these details. Work with them to see what is acceptable, and reasonable, during the bidding process. Your financial provider also can help you mitigate your exposure using the products mentioned above.

Q: Is it possible for my small to medium sized food and agriculture business to engage in a future or forward contract with my international buyers? If so, what do these mean to the profitability of my company?

A: This might be a possibility if your international buyers are willing to share in the currency fluctuation risk. You might be able to negotiate the revisiting of pricing at different stages of the project. Sometimes two counterparties agree to make each other whole relative to their agreed upon rates; however, we don't see this often.

Q: How can my small to medium sized business effectively mitigate the negative effects that a strong U.S. dollar has on our export profitability?

A: There must be a willingness on your company's part to price your goods in the foreign vendors working currency. This would not mitigate the negative effects of a strengthening U.S. dollar. It would, however, mitigate the currency fluctuations for your vendor, which would be paid in their working currency and eliminate the need to worry about conversion swings. Furthermore, the same can be said about allowing your vendors to pay you in their working currency. Be aware that this would switch the currency fluctuation risk to your company. You can consider hedging this risk by entering into forward contracts with your financial provider.

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